

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF NORTHERN KENTUCKY)	
WATER DISTRICT FOR A CERTIFICATE OF)	
CONVENIENCE AND NECESSITY FOR THE)	CASE NO. 2006-00315
CONSTRUCTION OF SUBDISTRICT F)	
WATER MAIN EXTENSIONS, FINANCING)	
AND SURCHARGE)	

ORDER

On September 20, 2006, the Commission denied the application of Northern Kentucky Water District ("NKWD") for authority to assess a surcharge to customers within its proposed Subdistrict F. NKWD petitioned for rehearing. After granting rehearing and receiving additional evidence upon the creation and characteristics of proposed Subdistrict F, we authorize the assessment of the proposed surcharge.¹

Having reviewed evidence of record and being otherwise sufficiently advised, the Commission finds that:

1. NKWD, a water district organized under KRS Chapter 74, provides retail and wholesale water service to Boone, Campbell, Kenton, and Pendleton counties, Kentucky.

¹ The Commission issued an Order on September 20, 2006 in which we denied NKWD's application for authorization to assess a surcharge on customers located in Subdistrict F. NKWD petitioned for rehearing. On October 19, 2006, we granted this petition and directed NKWD to file written testimony in support of its requested relief. We further directed NKWD to address several policy issues in this testimony. Following discovery and two informal conferences in this matter, the Commission scheduled a hearing in this matter for August 24, 2007. We subsequently postponed the hearing to permit the parties to address the potential effect on this proceeding of the Opinion and Order in *Commonwealth of Kentucky, ex rel. Gregory D. Stumbo, Attorney General, v. Public Service Commission and Union Light, Heat and Power Company*, Civil Action No. 06-CI-269 (Franklin Cir. Ct. Ky. Aug. 1, 2007). The parties subsequently waived their right to a hearing in this matter and requested a decision on the existing record. We find today that the Court's Opinion and Order does not immediately affect this proceeding and that it can continue without delay.

2. NKWD proposes to create for administrative, financing, and rate-making purposes a subdistrict known as "Subdistrict F."

3. Under NKWD's proposal, Subdistrict F will consist of the following areas in Campbell County, Kentucky:

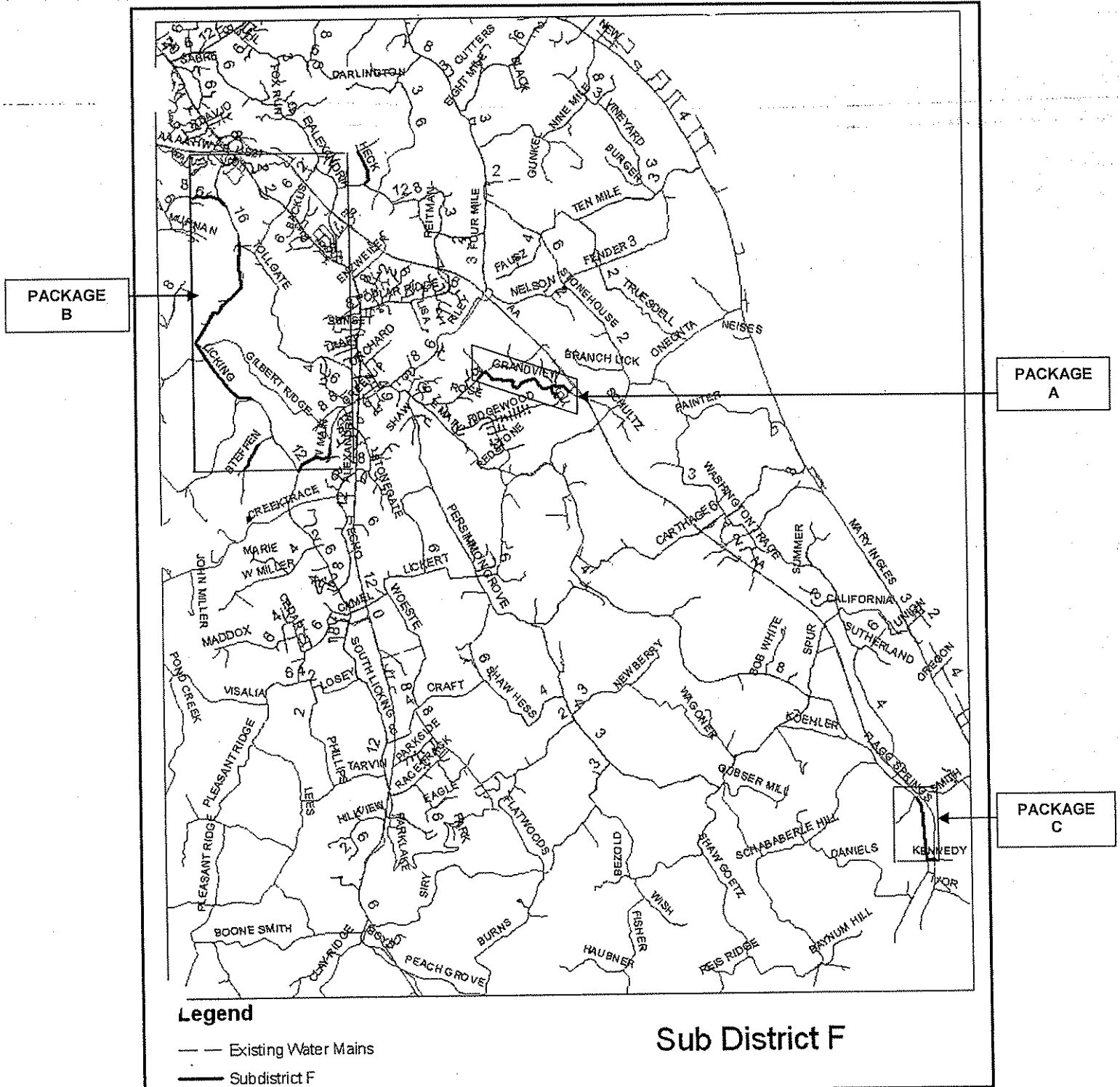
- a. Grandview Road
- b. Amy Lou Drive
- c. Heck Road
- d. Steffen Road
- e. Licking Pike (Existing 8 to Ripple Creek)
- f. Licking Pike (from Trapp Pike to Rifle Range Road)
- g. Licking Pike (from Rifle Range Road to Subdistrict D)
- h. Flagg Springs Pike (from Kennedy Drive to Ivor Road).

4. Areas of the proposed Subdistrict F are not contiguous, but widely dispersed. Portions of Subdistrict F territory are as much as 9 miles apart.

5. NKWD proposed and has been issued a Certificate of Public Convenience and Necessity to construct approximately 25,300 linear feet of 8-inch and 13,100 linear feet of 12-inch water transmission mains and related appurtenances within Subdistrict F to serve 136 additional customers. Approximately 44 of these customers have contracted for water service. The project has a possible customer density of 19.15 customers per mile.

6. The total construction cost is approximately \$2,539,803.

FIGURE I
NORTHERN KENTUCKY WATER DISTRICT
CAMPBELL COUNTY SERVICE



Source: NKWD's Application, Exhibit C. The boxed areas represent Subdistrict F territory.

7. The project is divided into three packages. The geographical location of each project is shown on Figure I. The characteristics of each package are set forth in Table I below:²

TABLE I						
Package	Cost	Total Available Customers	Customers Contracting for Service	Main Extension	Cost Per Foot	Customers Per Mile
A	\$ 737,690	55	26	11,300	\$65.28	25.70
B	\$1,188,972	66	18	20,900	56.89	16.67
C	\$ 447,709	15	0	5,300	84.47	14.95

8. None of the packages are geographically connected to the other or share a common geographical characteristic.

9. NKWD determined the areas for inclusion in proposed Subdistrict F through an analysis of all unserved areas of Campbell County that are within its territory. While hydraulic conditions, the availability of sewer service, geotechnical factors, the location of existing water distribution facilities, and conditions of financial grants were considered, NKWD grouped areas for inclusion within the proposed subdistrict primarily on customer density.³

² See NKWD's Application at Exhibit A. Table I assumes that Engineering, Geotechnical, Geotechnical Inspection, Administrative and Legal Fees, and Contingencies are equally allocated to each package. If these costs were excluded, Table I would appear as follows:

Package	Cost	Total Available Customers	Customers Contracting for Service	Main Extension (Feet)	Cost Per Foot	Customers Per Mile
A	\$485,286	55	26	11,300	\$42.95	25.70
B	\$936,568	66	18	20,900	44.81	16.67
C	\$195,305	15	0	5,300	36.85	14.95

Table I does not assume that Flagg Springs Market has executed a contract for water service.

³ Three segments of the proposed water main extension were based not upon customer density but the need for hydraulic improvement to provide for future extensions in unserved areas. See NKWD's Response to Staff Request and Waiver of Hearing.

10. The selection of unserved areas with the highest customer density maximizes the number of households added, ensures the most effective use of limited funds from government grants, and reduces the level of the surcharge.

11. The areas selected for inclusion in Subdistrict F have among the highest customer density of the unserved areas of Campbell County that are located in NKWD's territory.

12. Persons residing within the proposed Subdistrict F currently receive water service through cisterns and wells.⁴

13. No public or municipal utility currently provides water service to the proposed Subdistrict F.

14. NKWD funded the total construction cost from the following sources:

- a. Appropriated funds of \$1,288,000 from the Kentucky State Treasury;⁵
- b. A grant of \$25,000 from the Campbell County Fiscal Court;
- c. A contribution of \$55,000 from Flagg Springs Market;⁶
- d. Proceeds of existing and future debt instruments of \$1,171,803.

15. NKWD budgeted \$250,000 in its Fiscal Year 2006 capital budget and \$500,000 in its Fiscal Year 2007 capital budget toward the project. It proposed to obtain the remaining funds through the issuance of bond anticipation notes.

⁴ See Water Resource Information System, Kentucky Water Project Profile No. WX21037552, <http://wris.ky.gov/KIAProjs/> (last visited Sep. 19, 2006).

⁵ The Kentucky General Assembly appropriated this amount toward the projects in its 2005 General Session. See 2005 Kentucky Acts chap. 173, Part 1A9b(21); Legislative Research Commission, Fiscal Biennium 2004-2006 Commonwealth Budget – Final Budget Memorandum at 211 (Apr. 27, 2005).

⁶ NKWD Application at Exhibit F.

16. NKWD has allocated the funds that it will use for the proposed project to various debt instruments in the following manner:⁷

- a. \$250,000 from the proceeds of a 2006 general revenue bond issuance;⁸
- b. \$500,000 from Series 2003 B Bonds Payable;⁹
- c. \$421,803 from a future issuance of bond anticipation notes.

17. Of the \$1,171,803 which NKWD is funding through debt instrument proceeds, NKWD has designated \$175,515 as a "hydraulic improvement contribution" that should be funded through general rates. This amount represents the difference in cost between using 12-inch water mains and 8-inch water mains on certain portions of the proposed construction. NKWD states that the benefits of the use of the larger size mains accrue to all water customers, not merely those customers within Subdistrict F.

18. Of the \$1,171,803 which NKWD is funding through debt instrument proceeds, NKWD has designated \$750,000 as an "extension contribution." This amount represents the share of project costs that all NKWD customers will be funding through general service rates.

⁷ See Letter from John Scheben, Design Supervisor, Northern Kentucky Water District, to John N. Hughes, NKWD legal counsel (Aug. 25, 2006). In Case No. 2005-00148, the Commission approved rates for general service that included recovery of the debt service for the debt instruments listed in Findings Paragraphs 16a and 16b. See Case No. 2005-00148, Application of Northern Kentucky Water District For (A) An Adjustment of Rates; (B) A Certificate of Public Convenience and Necessity for Improvements to Water Facilities; and (C) Issuance of Bonds (Ky. PSC. Apr. 28, 2006) at 17-18.

⁸ See Letter from Scheben to Hughes. In Case No. 2005-00148, the Commission authorized NKWD to issue \$29,000,000 in parity revenue bonds. NKWD issued these bonds on September 1, 2006. See Annual Report of Northern Kentucky Water District to the Public Service Commission for the Calendar Year Ended December 31, 2006 at 23 and 23.11.

⁹ See Case No. 2002-00105, Application of Northern Kentucky Water District For (A) An Adjustment of Rates; (B) A Certificate of Public Convenience and Necessity for Improvements to Water Facilities; and (C) Issuance of Bonds (Ky. PSC Apr. 30, 2003) (authorizing parity bond issuance of \$30,270,000) at 28.

19. NKWD proposes that the remaining portion of the cost of the water main extension be apportioned to customers within Subdistrict F through a monthly surcharge not to exceed \$30. It estimates that such a surcharge will recover approximately \$246,288 of the extension's cost, exclusive of any interest on debt instruments issued to finance the proposed construction.¹⁰

20. In its application NKWD does not state an interest rate upon which the proposed surcharge is based or state a period of time during which the surcharge will be assessed.

21. Were NKWD to extend service to persons residing in the proposed Subdistrict F under its present water main extension rules,¹¹ each customer would be

¹⁰ This amount represents the net present value of the estimated surcharge proceeds over 25 years. NKWD assumes that Subdistrict F will serve an average of 48 households during the 25 years following the construction of the proposed water distribution mains. $\$432,000 = 48 \text{ households} \times \$30 \text{ per month} \times 300 \text{ months}$. NKWD Telephone conversation between John N. Hughes, NKWD legal counsel, and Gerald Wuetcher, Deputy General Counsel, Public Service Commission (Sep. 12, 2006).

¹¹ NKWD's published rate schedules provide:

The District shall pay that portion of the cost of the water main extension equal to 50 feet for each applicant for service. That part of the cost not covered by the District's portion shall be contributed equally by those applicants desiring service on the main extension. . . . For a period of five years after the original construction (water main placed in-service) of the main extension, each additional customer directly connected to the extension, and not to laterals and extensions therefrom, will be required to contribute to the cost of the extension based on a re-computation of both the District's portion of the total cost and each customer's contribution as described above. Each year the District will refund to those customers that previously contributed to the cost of each main extension that amount necessary to reduce their contribution to the currently calculated amount for each customer connected to the extension. All customers directly connected to each main extension for a five-year period after it is placed in service are to contribute equally to the cost of construction of the extension.

required to deposit \$21,960¹² with NKWD. It is highly unlikely that NKWD would be required to return this deposit.¹³

22. Assuming the proposed surcharge is not revised during the proposed authorization period of 25 years, a customer located in Subdistrict F would pay a total of \$9,000 toward the surcharge.¹⁴

Based upon these findings, the Commission makes the following conclusions of law:

1. Where a subdistrict is created for rate-making purposes, the areas placed within that subdistrict should have some common characteristic or interest. The proponent of the subdistrict's creation bears the burden of demonstrating the

¹² The amount of the customer deposit is calculated as follows:

Total cost of the extension after removal of government grants and costs related to up-sizing of main = \$1,051,288

Total Cost of Project		\$2,539,803
Minus: State Appropriated Funding	\$1,288,000	
Campbell County Grant	25,000	
NKWD Hydraulic Improvement Contribution	<u>\$ 175,515</u>	<u>1,488,515</u>
Remaining Cost Subject to Customer Finance		<u>\$1,051,288</u>

Average Cost of Water Main Extension = $\$1,051,288 \div 37,500 \text{ feet} = \28.03 per foot .

NKWD's Required Contribution per Customer = $50 \text{ feet} \times \$28.03 = \$1,401.50$.

NKWD's Total Required Contribution = $45 \text{ customers} \times \$1,401.50 = \$63,067.50$.

Total Cost of Project Subject to Customer Deposit: $\$1,051,288 - \$63,067.50 = \$988,220.50$.

Required Customer Deposit = $\$988,220.50 \div 45 \text{ customers} = \$21,960.46$.

Calculations assume that Flagg Springs Market has executed a contract for water service but has not made a separate contribution towards the water main's cost.

Assuming that 136 customers contracted for service within the first 5 years of the date on which the water mains were placed into service, each customer would contribute \$6,328.56. The record does not indicate that all potential customers would request service within this period. Given that any obligation to contribute to the cost of the water main extension ends after 5 years, it is likely that many customers would defer applying for service until the end of the 5-year period to avoid making any contribution.

¹³ Supra, note 11.

¹⁴ $\$30 \times 12 \text{ months per year} \times 25 \text{ years} = \$9,000$.

reasonableness of the subdistrict's boundaries. At a minimum, it should demonstrate that the subdistrict's territories are served by common utility plant and facilities or share common geographic characteristics. Absent such demonstration, any rate that is based solely on a customer's location within the subdistrict's territory may be deemed unreasonable.¹⁵

2. The areas within the proposed Subdistrict F share a common characteristic – high customer population density – when compared to other unserved areas with Campbell County.

3. The use of customer density as the distinguishing factor to develop a rate to recover the cost of water main extensions to unserved areas may be reasonable depending upon the circumstances of the extension.¹⁶

4. KRS 278.040(3) and KRS 278.280(1) authorize the Commission to develop rules for the furnishing of utility service to the public.

5. Administrative Regulation 807 KAR 5:066, Section 11(1) and (2), establishes a methodology for water main distribution extensions. Administrative Regulation 807 KAR 5:066, Section 11(4), permits a water utility to develop arrangements for water distribution main extensions that differ from this methodology.

¹⁵ Case No. 2000-171, Application of Northern Kentucky Water Service District for a Certificate of Public Convenience and Necessity for the Construction of Sub-District D Water Main Extensions and Surcharge (Ky. PSC May 31, 2000) at 8.

¹⁶ In any future proceeding in which NKWD applies for authority to assess a surcharge to finance a water distribution main extension to an unserved area, it should include in its application a listing of all unserved areas within its territory ranked according to customer density. Such listing should clearly indicate the unserved areas that are included in the proposed subdistrict and identified any special circumstances that supported inclusion of the unserved area in the proposed subdistrict (e.g., area located along a route needed to connect higher density areas; inclusion allows for hydraulic improvement for future extensions). For an example of such a listing, see NKWD's Response to Staff Request and Waiver of Hearing, Attachment A. NKWD should also clearly identify all other factors that were considered in its selection of the areas to be included in the proposed subdistrict and describe the effect of these factors on its decision.

6. The proposed surcharge represents a different arrangement for making water distribution main extensions.

7. Under the circumstances NKWD has demonstrated that its formulation and calculation of the proposed surcharge results in a fair and reasonable rate and a reasonable alternative to existing methods of making water distribution main extensions.

8. NKWD's proposed plan of financing the water distribution main extension does not involve the immediate issuance of any long-term evidences of indebtedness and, therefore, does not require Commission authorization.¹⁷ Prior to the issuance of any long-term evidences of indebtedness that will refund or retire any bond anticipation notes used to finance the proposed construction, however, NKWD should seek Commission authorization for such action.

IT IS THEREFORE ORDERED that:

1. NKWD is authorized to assess each customer of Subdistrict F a monthly surcharge of \$30 subject to the conditions set forth in Ordering Paragraphs 2 through 10.

2. NKWD shall cease collection of the surcharge 25 years from the date of this Order or upon the billing of \$432,000¹⁸ to customers of Subdistrict F facilities, whichever occurs first.

3. NKWD shall identify the surcharge as a separate line item on its bills to Subdistrict F customers.

¹⁷ KRS 278.300(8). The Commission has previously authorized the issuance of the bonds referenced in Findings Paragraph 16(a). Northern Kentucky Water District, supra note 6.

¹⁸ This amount is based upon the assumption that Subdistrict F would serve an average of 48 households during the 25 years following the construction of the proposed water distribution mains. \$432,000 = 48 households x \$30 per month x 300 months.

4. On April 1, 2009, and each year thereafter so long as NKWD assesses the surcharge, NKWD will adjust the surcharge level to reflect the number of Subdistrict F customers as of December 31 of the preceding year and the annual expected revenue of \$17,280.¹⁹ In no event, however, shall the level of the surcharge exceed \$30 per month.

5. Beginning in calendar year 2008, for the period from the date of this Order, and for each calendar year thereafter in which the surcharge is effective, NKWD shall submit with the annual financial and statistical report required by Administrative Regulation 807 KAR 5:006, Section 3(1), a written report stating:

- a. The number of customers in Subdistrict F as of December 31 of the preceding year;
- b. The total surcharge billed during the preceding calendar year;
- c. The total surcharge billed since the date of this Order;

6. In its written report submitted for calendar year 2012, NKWD shall describe how Subdistrict F facilities have been integrated into NKWD's overall operations, shall list and describe the benefits, if any, that Subdistrict F facilities provide to non-Subdistrict F customers, and shall state whether further adjustments to the surcharge are necessary to reflect these benefits.

7. NKWD shall for accounting purposes maintain separate accounts for the billing and collection of surcharge proceeds.

8. Within 20 days of the date of this Order, NKWD shall revise its filed rate schedules to contain the Subdistrict F surcharge and a description of the area that

¹⁹ \$17,280 = 48 households x \$30 per month x 12 months.

Subdistrict F comprises. At a minimum, this description shall include a map of the general area and a listing of all streets and roadways within Subdistrict F.

9. NKWD shall maintain a current description of Subdistrict F in its filed rate schedules so long as the Subdistrict F surcharge is effective.

10. All persons who receive water service through the Subdistrict F facilities or through water mains that are laterals to or extensions of those facilities and are not part of any NKWD subdistrict that is subsequently created, shall be considered within Subdistrict F and shall be assessed the surcharge.

Done at Frankfort, Kentucky, this 26th day of December, 2007.

By the Commission

ATTEST


Executive Director